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No. 55

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

PACIFIC GAS & ELECTRIC COMPANY,
Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF OF PACIFIC GAS AND ELECTRIC COMPANY

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I

The Commission expressly grounds its decision on a construction of the Act which is erroneous.

The first argument in the Commission's brief is entitled "There is no substantial dispute between the parties as to statutory construction" (Comm. Br., p. 32).

This is followed by an assertion (p. 43) that there are no questions of law involved, but a question of fact only; and that the Commission decision can be upset only if this Court decides "that the evidence so strongly demanded an affirmative finding of lack of controlling influence as to exclude any 'rational basis' for the Commission's refusal to make such an affirmative finding. Unless the Court can

so decide, the Commission's determination must stand • • • but in any event the question is one of fact, not of law."

This is a complete misconception of petitioner's position, and is directly contrary to the Commission's own view of the issue between it and the examiner who recommended that the application be granted.

The Commission characterized the issue, not as one of fact but, on the contrary,

> "The point of issue • • • is rather one of statutory interpretation and in this respect we cannot agree with the conclusions reached by the trial examiner" (R. VI, 1912).

It then pointed out its view of the law that

> "the application herein cannot be granted unless we can find that applicant has sustained the burden of demonstrating that its management and policies are not subject to the controlling influence of North American" (R. VI, 1912).

and

> "'subject to a controlling influence' includes susceptibility to domination" (R. VI, 1913);

and concluded by its ultimate summing up:

> "The only question which we have decided is that, in the circumstance of this case where the statute presumptively requires that PG&E be regulated as a subsidiary of North American, the facts in the record before us do not demonstrate that PG&E is entitled to be excepted from the general requirement of regulation as a subsidiary of a registered holding company" (R. VI, 1931).

We believed the issues of law to be clear from the Commission's opinion, and our brief, but as counsel appears uncertain, we summarize them as follows:

1. The Commission misapprehended the statutory test of a subsidiary. It considered any utility, 10 percent or more of whose voting stock is owned by a holding company, to be a subsidiary, whereas the statute, properly construed, requires that for such a utility to be a subsidiary it must be "subject to the controlling influence" of a holding company.

2. The Commission erroneously held that 10 percent-owned, but non-controlled, utilities are merely an "exception" to the statutory design to regulate all such utilities. Counsel refers to an applicant, as one applying "for an exception under the statute", and states that "petitioner had not established its right to relief" (Comm. Brief pp. 27, 76).

3. The Commission imposed the impossible burden of "demonstrating" a negative.

4. The Commission held that an existing controlling influence was proved by the mere future possibility of such influence; that "susceptibility to domination" was the same as "subject to a controlling influence."

5. It held that a "substantial influence" was a "controlling influence."

6. It held that an influence sufficient (with the help which could be obtained from other stockholders) to compel good management was a "controlling influence", sufficient to meet the statutory requirement that the controlling influence be sufficient to effect the evils which the Act was designed to prevent, i. e., transactions between the utility and the holding company not at arms length, etc.

Singly, and in the aggregate, these errors constitute a failure of the Commission to follow its statutory authority. It is no answer to argue that had the Commission correctly

pursued the statute, it could have come to the same conclusion, for that would be to substitute the Court's view for that of the Commission; and Congress entrusted this power to the Commission and not to the Court. That the Commission would have reached the same conclusion if it had properly applied the law, is mere speculation. *Securities and Exchange Comm.* v. *Chenery Corporation*, 318 U. S. 80, 93.

There could be no clearer case than this for the application of the rule of statutory construction (applicable also to review of administrative action), which is declared in a long line of cases, and summarized in the following from *Florida* v. *United States*, 282 U. S. 194, 211.

> "The question in the present cases, then, is not one of authority, but of its appropriate exercise. The propriety of the exertion of the authority must be tested by its relation to the purpose of the grant and with suitable regard to the principle that whenever the federal power is exerted within what would otherwise be the domain of state power, the justification of the exercise of the federal power must clearly appear."

See also *Ill. Cent. R. R.* v. *Public Utilities Comm.*, 245 U. S. 493; *United States* v. *Baltimore & Ohio R. R.*, 293 U. S. 454, 464.

In *United States* v. *Carolina Carriers Corp.*, 315 U. S. 475, 489, this Court said:

> "Congress has made a grant of rights to carriers such as appellee. Congress has prescribed statutory standards pursuant to which those rights are to be determined. Neither the Court nor the Commission is warranted in departing from those standards because of any doubts which may exist as to the wisdom of following the course which Congress has chosen. Congress has also provided for judicial review as an additional assurance that its policies be executed. That

> review certainly entails an inquiry as to whether the Commission has employed those statutory standards. If that inquiry is halted at the threshold by reason of the fact that it is impossible to say whether or not those standards have been applied, then that review has indeed become a perfunctory process. If, as seems likely here, an erroneous statutory construction lies hidden in vague findings, then statutory rights will be whittled away. An insistence upon the findings which Congress has made basic and essential to the Commission's action is no intrusion into the administrative domain. It is no more and no less than an insistence upon the observance of those standards which Congress has made 'prerequisite to the operation of its statutory command.' *Opp Cotton Mills* v. *Administrator*, 312 U. S. 126, 144. Hence that requirement is not a mere formal one. Only when the statutory standards have been applied can the question be reached as to whether the findings are supported by evidence."

Pacific Gas is a California utility whose properties and business have always been exclusively confined within that State. Clearly Congress did not intend that such a local utility should be subjected to Federal control, unless in fact part of a holding company because "subject to its controlling influence". The statute shows as strong a desire to exclude non-controlled local utilities from the Act, as to include "controlled" utilities. The Commission was authorized and directed to draw the line between Federal and State jurisdiction pursuant to the clearly expressed Congressional mandate. Here it drew the line to include Pacific Gas; but its conclusion is clearly based on a misinterpretation of the Act.

Counsel urges that the Commission's expressions are not to be taken to mean what they say: that "demonstrate", repeatedly used, means only "prove"; that "substantial influence" was intended to mean "controlling influence",

and so on. Here, as elsewhere in marking the line between State and Federal powers,

> "Proper regard for the rightful concern of local interests * * * makes desirable the requirement that federal power be exercised only where the statutory authority affirmatively appears. The sacrifice of these legitimate local interests may be as readily achieved through the Commission's oversight or neglect * * * as by improper findings. The insistence that the Commission make these jurisdictional findings before it undertakes to act not only gives added assurance that the local interests for which Congress expressed its solicitude will be safeguarded. It also gives to the reviewing courts the assistance of an expert judgment on a knotty phase of a technical subject." (*Yonkers* v. *United States*, 320 U. S. 685, 690). And see *S. E. C.* v. *Chenery Corp.*, 318 U. S. 80, 93-95.

Here, the concern of the State of California over this attempted extension of Federal Power into what has heretofore been its exclusive domain, is demonstrated by the appearance of the California Railroad Commission in the proceeding, its showing of its complete jurisdiction over Pacific Gas, and its statement that it is aware of no instance when the management or policies of Pacific Gas have been either controlled or influenced by North American; and it perceives no public interest which compels the conclusion that Pacific Gas should be declared subject to the Act. (R. VI, 1871-6.)

Counsel asserts that "The courts have uniformly sustained the Commission's understanding of the law." (Comm. Br. p. 37.) We respectfully submit that the Commission's interpretations of the law as here made and challenged by us have not been passed upon by the courts. In the Detroit Edison, Public Service of New Jersey, Hartford, Koppers and American Gas cases, the facts over-

whelmingly showed the existence of a present controlling influence, and intercompany transactions. In at least three of the cases, actual exercise of a controlling influence in the past were admitted facts. None of these courts approved the Commission's view that "susceptibility to domination" is "controlling influence", or that a "substantial influence" is a "controlling influence." They all held, as urged by the Commission, that a "controlling influence" need not be presently exercised, if it presently exists, in order to bring a local utility within the Act, but we have never contended the contrary, and the point is not involved here.

II

The Commission fails in its attempt to show substantial evidence for its conclusion.

The second part of the Commission brief is devoted to the contention that its conclusion is supported by substantial evidence.

In the course of that argument the statement is made that "petitioner has not disputed any of the Commission's findings set forth in the statement above at pp. 8-24" (Comm. Br. p. 47). That statement begins, "The facts, as detailed in the findings and opinion of the Commission • • • may be summarized as follows" (Comm. Br. p. 8).

We are at a loss to explain counsel's statement because a substantial part of our brief is devoted to proving that the Commission's statement of the facts is incomplete and inaccurate, and "that some of the statements made in the Commission's opinion must be characterized as lacking in candor" (Pet. Br. pp. 59-93). This is also the view of Judge Garrecht and Judge Matthews, who said,

> "We call attention to the fact that the findings and conclusions of the Commission are based on inference and surmise in many instances in absolute conflict

with the testimony which was uncontradicted and not discredited". (R.V., 1747; see also pp. 1758, 1761, 1771, and 1775.)

Counsel's entire argument is founded upon the Commission's statement of the evidence, which, as shown in our brief, is neither a full nor a fair statement of the evidence as it appears in the record. Time and space do not permit a detailed comparison of the record with the statement of facts in counsel's brief, but we point out some typical instances where the statements are not supported by the record. Important evidentiary facts not mentioned at all are so extensive that it is impossible to deal with them here, but reference is made to the examiner's findings (R. VI, 1780), which fully states the evidentiary facts, as to which counsel concedes there is no dispute (Comm. Br. p. 8, note 6).

1. Counsel repeatedly refers to the fact that "Since 1932 • • • at no meeting were enough shares present, apart from the shares held by North American, to constitute a quorum" (Comm. Br. p. 22), and in a footnote on page 23 sets forth what is stated to be a table from the Commission's opinion showing the representation at stockholders meetings. But in reproducing the table, the year 1931 which appears in the table in the Commission's opinion (R. VI, 1899) has been omitted entirely. The omitted material shows that in that year there were present, at two separate meetings, stockholders other than North American representing 50.2 percent, and 57.7 percent respectively (R. VI, 1899). Later in the brief counsel goes even further, dropping out the qualifying words "Since 1932", and says (p. 66), "Since the inception of the arrangement P. G. & E. could have conducted no business at any of its stockholders meetings without the approval and votes of North American". Since the "arrangement" was made

in 1930, counsel has thus overlooked the two meetings in 1931, as to which his statement is inaccurate.

Counsel, as well as the Commission, has wholly failed to mention or give effect to the testimony and the finding of the examiner that "an attendance of 75 percent or more of the stockholders could have been and can be obtained for any stockholders meeting by sending out a second notice" (R. VI, 1843), thus showing that attendance by North American is not necessary to obtain a majority representation at stockholders meetings. As a large part of the argument is based on the alleged inability of Pacific Gas to hold stockholders meetings without North American attendance, the fact that it has had two such meetings since North American became a stockholder, and that it can obtain a quorum without North American attendance, are important, and failure to mention them is an unfortunate oversight. Since lack of a quorum would continue the incumbent directors in office, with power to fill vacancies, it is difficult to see what probative force the point has in any event.

2. Counsel states, quoting the Commission opinion, "none of P. G. & E.'s other large stockholders is represented on its Board" (Comm. Br. p. 17). The stock interests of the directors are summarized on pages 1805-6 of R. VI, showing that (eliminating the two North American directors) all of the directors (excepting Foote, the Secretary) are substantial stockholders, and that six each have stock interests exceeding 90,000 shares,—stock interests being shares owned personally, or by family and affiliated interests. 90,000 shares have a value of approximately $2,500,000. The only foundation for the Commission's statement would seem to be the directors' testimony that they considered they represented all stockholders and not any particular stockholder.

3. Counsel details, as does the Commission's opinion, that Pacific Gas sends to North American a variety of detailed weekly and monthly reports (Comm. Br., p. 18); and states that "North American has never requested any information from P. G. & E. which has not been furnished" (p. 19). This implies that much information is requested, and that North American receives detailed reports not available to others. The evidence shows that the reports are sent to Fogarty and Freeman as directors, that they consist principally of reports submitted to meetings of the directors and executive committee, and are sent to them after they have been submitted at such meetings (R. I, 425, 434, R. II, 497). They convey less information than is received by those who attend the meetings (R. VI, 1835). The other reports are formal reports having wide circulation, such as reports to the Edison Electric Institute, and to the insurance companies, sent to 400 companies (R. II, 748-50). Copies of rate schedules were not sent until after they had been filed and approved by the Railroad Commission (R. II, 749).

4. Counsel states "The record shows only one occasion, prior to the time when Black became president, when North American's wishes on a particular matter were contrary to the action of P. G. & E.'s directors" (Comm. Br. p. 20). This repeats a statement from the commission's opinion (R. 1911). It implies that on various occasions North American's "wishes" were communicated and complied with. The record shows that North American never expressed or communicated a wish or request to Pacific Gas regarding to affairs at any time either before or since Mr. Black became president, except in 1933, when the directors reduced the dividend, and North American requested that the action be reconsidered, but it never was. Elaborate argument is made to overcome the probative effect of this fact as show-

ing lack of influence. Counsel says, "The request was mild in terms, and when it was refused North American did not regard the matter as of sufficient importance to call for any further attempt to obtain reconsideration" (Comm. Br. 59). The action reduced by one fourth North American's income from Pacific Gas, and the attempt to depreciate its importance is hardly consistent with Counsel's previous statement (p. 9) that the holding was important to North American because "The dividends from it have constituted between 20% and 25% of North American's corporate gross income." Nor is it consistent with the fact that North American made strenuous efforts to secure reconsideration of the reduction (R. III, 1068; R. IV, 1625). It is significant also, that North American only learned of the dividend reduction after it had had been made (R. III, 1068).

5. Counsel refers (p. 20) to a "practice of asking North American's advice in connection with proposed financing." Again he says (p. 57), "Ever since Black became petitioner's president he has called Fogarty, Chairman of North American's executive and finance committees, a number of times each year to seek advice concerning petitioner's financial affairs"; and quotes from a court decision to the effect that "Under some circumstances 'controlling influence may spring as readily from advice constantly sought as from command arbitrarily imposed.'" And again, (p. 66) counsel says that "The advice of North American representatives has been frequently sought, at least on financial matters." The implication of this is that Mr. Black was constantly seeking advice from North American. This is contrary to the evidence. Mr. Black never sought advice from North American (R. III, pp. 1081, 1152). In 1938 Mr. Black asked Mr. Fogarty how much he thought the discount should be in a private sale of bonds to an insurance company, to interest them (R. III, 1191). He called

Mr. Fogarty occasionally when Pacific Gas was selling bonds "to get their advice on what the market might be doing" and "get their ideas on prices of bonds, what the market might stand, as we got closer to the dates of our offerings. That is the kind of information, of course, that I was getting from all directors and from any source which I could get. Q. That was information rather than advice, was it not? A. Yes." (R. III, 1081.) Under examination by Commission counsel, he testified, "Q. Would it be fair to say that North American is not consulted with reference to financing projects of the Applicant until they have reached a fairly definite stage? A. It would be accurate to say that they are not consulted in the formulating of any of our financial plans" (R. III, 1291. See also R. VI, 1863-8). The Commission searched the telephone company records and found the following to be the total of calls between Pacific Gas and North American.

	From Pacific Gas	From North American
1937	2	2
1938	6	3
1939	3	2

This is to be contrasted with the private wire which North American maintained with its subsidiaries (R. III, 1227).

6. Counsel, on page 53, comments on Pacific Gas financing, seeming to imply that there was something improper in selecting Blyth & Co., a San Francisco house, to head the company's financing. Indeed testimony covering hundreds of pages was introduced by the Commission on the question of financing, and it devotes two pages of its opinion to discussion of the subject. The fact is, however, as shown in the record without any dispute or qualification,

that North American has never participated in any way in Pacific Gas financing or been asked its advice respecting the membership groups, that Pacific Gas has always handled its own financial arrangements by negotiations in San Francisco, and has selected a San Francisco firm to head its underwriting syndicates in recent years, with a heavy participation by other California firms, because it felt it to be in the best interest of the company to have local underwriters to the fullest extent possible (R. III, 1093).

North American has never been consulted in the formulation of any of Pacific Gas financial plans (R. III, 1291; R. VI, 1863-8).

Why so much attention should be devoted to financing is not apparent; but it is clear that after all the testimony and all the comment, the fact is unassailable, that North American has never had the slightest thing to do with Pacific Gas financing.

The most the Commission found was "substantial influence"—not "controlling influence".

In the Commission's brief, pages 47 to 73, is a summation of evidence claimed to be substantial support for the action of the Commission. As pointed out, and as a comparison with the findings of the examiner and an examination of the record will show, it is not a statement even in substance of all the evidence, and in several important particulars is contrary to the evidence. It is reasonable to conclude that the Commission's decision is based on the evidence recited in its opinion. If so, then its action was arbitrary, since facts and circumstances which ought to have been considered were excluded from consideration. *St. Joseph's Stock Yards Co.* v. *United States,* 298 U. S. 38, 74; *Fed. Trade Com.* v. *Curtis Publishing Co.,* 260 U. S. 568, 580.

But considering the various factors which the Commission recites, and ascribing to them the full effect which it, in its expert judgment, deemed proper, there is no escape from the conclusion that their total cumulative effect, in the opinion of the Commission, was only this:

> "• • • that North American has the power—if the occasion arises and if it so desires—to make its influence felt in a substantial and affirmative manner." (R. VI, 1922.)

This falls far short of a finding that Pacific Gas is "subject to the controlling influence" of North American. Yet counsel asserts that this finding is sufficient to support its ultimate conclusion that Pacific Gas failed to establish the absence of an existing "controlling influence" (Comm. Br. p. 42). This conclusion, couched in the language of the statute, is not a finding of fact at all, (*United States* v. *Chi., M., St. P. and P. R. Co.*, 294 U. S. 499, 506), which leaves the ultimate factual finding of the Commission, comprehending in its expert judgment the entire effect of all the evidence, that North America has the power to make its influence felt in "a substantial and affirmative manner". That is all the Commission could find, and we submit it is fair from this to conclude that the Commission itself did not believe the record would sustain a finding of the existence of a "controlling influence."

The Commission's brief (p. 42) admits the patent fact that the Commission did not find that a controlling influence exists, and that the finding of power to "make its influence felt in a substantial and affirmative manner" is only a finding of some degree of influence less than controlling.

The Commission's reasoning therefore comes to this: that although an exhaustive scrutiny of the record did not result in a finding that controlling influence was present, it did supply a sufficient basis for a finding that North American could, if occasion arose, "make its influence felt

in a substantial and affirmative manner" (R. VI, 1922). The Commission believed this a sufficient basis for its conclusion that the applicant had failed to show the absence of a "controlling influence" notwithstanding the otherwise uncontradicted and comprehensive evidence to that effect because under its construction of the Act, North American's stock ownership creates a situation in which

> "the statute presumptively requires that P. G. & E. be regulated as a subsidiary of North American";

and since the facts in the record

> "do not demonstrate that P. G. & E. is entitled to be excepted from the general requirement of regulation as a subsidiary of a registered holding company" (R. Vol. VI, 1931),

the Commission has authority to refuse to declare that Pacific Gas is not a subsidiary of North American.

In short, the Commission's decision rests on the grounds stated by it; namely, that since lack of controlling influence is merely a statutory exception to the Act's purpose of regulating all local public utilities of whose stock 10 percent or more is owned by a holding company, the right to escape from the Act under the exception requires a degree of proof sufficient to "demonstrate" that the case is within the exception.

But this construction of the Act is shown in our brief (p. 26 et. seq.) to be contrary both of the language of the Act and its entire history; it follows that the Commission's decision based thereon should not stand.

The possibility of North American's intervening to correct Pacific Gas mismanagement is no evidence of a present controlling influence, as the Commission contends.

It is fair to say that the aggregate effect of all of the various circumstances marshalled by the Commission and

its counsel, is, as the Commission states, (R. VI, p. 1920-4), that if at some future time Pacific Gas were mismanaged, North American could secure enough support from other stockholders to correct the situation and insure good management. But any stockholder has the same opportunity. Any substantial Californian would have far greater chance of accomplishing this than North American, a New York holding company, under death sentence imposed under a statute deemed necessary in the public interest because of evils inherent in the holding company device. Whether North American could do even this is the merest speculation; it surely is not evidence of a present controlling influence.

But even if it were a fact that at some future time North American could gain support of other stockholders to correct mismanagement of Pacific Gas, that is not a power which the Act considers a "controlling influence". The Commission itself has stated that the quantum of power essential to constitute a controlling influence is influence sufficiently extensive "to embrace the power to bring about the evils which the Act is designed to guard against". (Manchester Gas Co., 7 S. E. C. 57, 62). Power to join with others to correct mismanagement is not power to impose conduct which would "bring about" the evils defined in the Act (Sec. 1(b)), such as those arising out of transactions between holding companies and subsidiaries not at arms length, the issue of watered securities and similar evils, all of which amount to bad management and the milking of local utilities for the benefit of a holding company.

Surely the ability of North American as a stockholder, to join with others to protect its investment against mismanagement, is not the "controlling influence" mentioned in the Act; and yet that is the maximum power that counsel and the Commission suggest.

The spectacle of a holding company under sentence of death, and whose right to solicit proxies is subject to the jurisdiction of the Commission, engaging in proxy solicitation for the purpose of gaining a "controlling influence" to compel Pacific Gas, against its will, to engage in evil practices condemned by the Act—and being successful—is beyond the realm of fancy, let along rational inference.

Conclusion

Counsel for respondent points out that North American has committed itself to a program of systematic disposition of its Pacific Gas stock which if adhered to will reduce its holdings below 10 percent by January, 1946. Also that North American is under Commission order to dispose of its stock in Pacific Gas and has claimed no error in that determination, save a constitutional objection. Also that Pacific Gas has never complied with the requirements of the Act because the Commission order has been stayed pending the outcome of this case (Comm. Br., note, p. 8); and "Thus, the decision of this case, if favorable to the Commission, will subject the petitioner to the responsibilities and restrictions of a subsidiary for only a relatively short period"[1] (Comm. Br., note, p. 26). It concludes:

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[1] This statement of commission counsel is a startling acknowledgment that the sole ground for denying the Pacific Gas application was the stockholding of North American in excess of 10%, for counsel assents that as soon as the holding falls below 10% Pacific Gas will no longer be subject to the Act. This is a patent admission that there is no basis in the evidence for the Commission's decision except the stockholding in excess of the statutory 10%, and that Pacific Gas is a subsidiary solely because of the definition in the Act.

> "the one important consequence of subjecting petitioner to the obligations of a subsidiary company would be to render its future [security] issues subject to the requirement of competitive bidding" (Comm. Br., p. 72).

The purpose of these statements is not clear. If meant to suggest that Pacific Gas will not be greatly injured by being subjected to the Act—even though unjustly—the inference is unfounded.

The powers of the Commission over subsidiaries extend far beyond that of requiring public bidding on security issues. They include the requirement of Commission approval for the issue of all securities, the alteration of preferences or voting rights of outstanding securities, the acquisition of any securities or interest in any business; they prohibit the payment of dividends or the acquisition, retirement or redemption of its securities except under Commission rules, and include a number of other powers including extensive visitorial powers. The Act itself characterizes these as the "obligations, duties and liabilities imposed by the Act".

But all this would not be the only effect on Pacific Gas if it should be made subject to the Act. Of far greater importance to it is the fact that it has always, with justice and pride, been considered by the California public, and by its stockholders and consumers, as an independent self-sufficient California company, managed and operated by Californians, for the service of Californians.

Largely due to the high regard in which it has been held by its consumers and the residents of its territory, it has sold, commencing in 1914, directly to purchasers, largely through its employees, more than $76,000,000 of preferred stock in 68,668 individual sales, at a cost of less than 64 cents per $100 par value, and more than $65,000,000 of common

stock—a predominent proportion of both to residents of its territory, with resultant improvement in public and consumer relationships (R. VI, 1801). Pacific Gas was the originator of customer ownership in the public utility field (R. II, p. 754-65).

To have the Commission and this Court find that Pacific Gas is now, and ever since 1930 has been, under the "controlling influence" of a New York holding company, and that it is necessary that it be taken into the custody of the Commission because "necessary or appropriate in the public interest or for the protection of investors or consumers", would be not only unjust, but would constitute a serious blow to the standing, prestige, and public relations of this California company.

Respectfully submitted,

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